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April 24, 2020

Tracy Swalwell
Iowa Insurance Division
Two Ruan Center
601 Locust Street, Fourth Floor
Des Moines, Iowa 50309

Re: Comments on Iowa's Proposed Best Interest Obligations for Recommendations of Securities and Annuities

Dear Ms. Swalwell:

On behalf of a group of firm clients, including brokerage firms, mutual funds, insurance companies, asset managers, and banks, we are writing to provide comments on Iowa's proposed best interest obligations for recommendations of securities and annuities. Although most of our comments exclusively relate to the proposed best interest obligation for securities recommendations, the request for a delay of the rulemaking in light of the ongoing pandemic applies equally to the proposed best interest obligations for recommendations of securities and annuities.

SUMMARY

We have five main points, which are summarized here and discussed in more detail below.

I. **Request for delay of rulemaking in light of ongoing pandemic.** In light of the ongoing health and economic crises created by COVID-19, we are asking the Insurance Division to consider delaying its current rulemaking regarding both annuities and securities.

II. **Support for a national best interest standard for securities to protect investors in the most effective manner.** We strongly support the application of the Securities and Exchange Commission's ("SEC's") Regulation Best Interest to securities recommendations provided to retail investors by broker-dealers and have great concerns about the application of any state-level securities standards that add to or differ from the federal standard. Although Iowa's best interest proposal for securities recommendations is very similar to the SEC's Regulation Best Interest, the two rules are different in material ways, as discussed below. Even if these differences are eliminated, unless the Insurance Division creates a safe harbor under which a broker-dealer who satisfies the SEC's standards will automatically satisfy Iowa's standard, we must assume that the two standards will be interpreted and applied differently, resulting in confusing, duplicative, and overlapping regulatory regimes. Any differences will create unnecessary costs for investors. Accordingly, we ask you to consider creating a safe harbor for broker-dealers who satisfy the federal standard.

III. **Treating non-fraudulent actions as fraud and private causes of action.** The Insurance Division should modify the proposal so that non-fraudulent failures are not automatically treated as fraud for no apparent policy reason. This characterization is inappropriate and has no basis. Additionally, it appears that violations of the proposed securities rule could be enforced through a private cause of action, directly contrary to Regulation Best Interest and the insurance proposal. This would raise costs significantly and lead to far less brokerage services in Iowa. The Insurance Division should revise its proposed rule to make clear that it does not create or imply any private cause of action.

IV. **Conforming the proposal to Regulation Best Interest.** Iowa's securities proposal differs from Regulation Best Interest in material ways, primarily a disclosure and oversight obligation that does not appear in the SEC's Regulation Best Interest. If Iowa proceeds with its best interest obligation for broker-dealers and does not create the safe harbor described above, we urge the Insurance Division to conform the proposal so that it does not differ from Regulation Best Interest, to avoid the adverse consequences described above.

V. **Preemption.** Any Iowa broker-dealer standards that add to or differ from the SEC's broker-dealer standards will likely be preempted and invalidated based on two separate preemption rules discussed below. Iowa's proposal would be preempted because it adds to the federal regulation of broker-dealers by: (1) creating new disclosure requirements; and (2) creating a new private enforcement right, both of which the SEC expressly rejected when it recently promulgated its own standards of conduct for broker-dealers.

DISCUSSION

I. Request for delay of rulemaking in light of ongoing pandemic.

Before discussing our more substantive concerns with Iowa's proposed best interest obligation for securities recommendations, we first want to ask the Insurance Division to consider delaying its current rulemaking regarding both annuities and securities in light of the ongoing business continuity efforts underway due to the health and economic crises created by COVID-19.

Broker-dealers, insurance companies, and other financial services firms are currently operating under extremely difficult business conditions to support their customers during this crisis. Like other industries, many broker-dealer firms and insurance companies have closed their ordinary worksites and switched to work from home operations. Nevertheless, these firms are currently expending significant resources to serve their customers' unique needs during this crisis. In fact, because of the current market volatility and other economic conditions, broker-dealers and insurers are experiencing a significant surge in client interactions.

Due to these extreme conditions, we request that the Insurance Division consider delaying its best interest proposals for future consideration.

II. **<u>Support for a national best interest standard for securities to protect investors in the most effective manner.</u>**

The SEC's Regulation Best Interest is set to become effective on June 30, 2020. We strongly support the application of the SEC's Regulation Best Interest to securities recommendations provided to retail investors by broker-dealers, and we believe that investors are best served by having broker-dealers subject to this workable set of national rules promulgated by the SEC.

In contrast, we have great concerns about the application of any state-level securities standards that add to or differ from the federal standard because this sort of state regulation will unnecessarily add to a comprehensive set of federal regulations and potentially result in a patchwork of inconsistent rules. Furthermore, we believe that inconsistent state regulation will create a variety of harms for broker-dealers and investors. As SEC Chair Jay Clayton said in his June 5, 2019 statement:

> Recent examples of increases in . . . regulatory complexity include, among other things, (1) the Department of Labor's now vacated Fiduciary Rule, which would have imposed a standard of conduct different from both our existing standard of conduct for broker-dealers and the fiduciary standard applicable to investment advisers under the Advisers Act, and (2) the potential patchwork of inconsistent state-level standards. ***I and many others believe a patchwork approach to the regulation of the vast market for retail investment advice will increase costs, limit choice for retail investors and make oversight and enforcement more difficult.*** I am hopeful that our regulatory colleagues will continue to work with us to minimize inconsistencies and maximize the effectiveness of our collective efforts.

Although Iowa's best interest proposal for broker-dealers is very similar to the SEC's Regulation Best Interest, the two rules have material differences, as discussed below. Even if the two rules were facially identical, unless the Insurance Division expressly states that a broker-dealer who satisfies the SEC's standards will automatically satisfy Iowa's standard, we must assume that the two standards will be interpreted and applied differently. This is very concerning:

- **<u>Additional costs, depleting investor savings.</u>** For broker-dealers operating in many or all states, the cost of designing, maintaining, training, and oversight with respect to different rules in different states is very material. And those costs will certainly be passed on to investors. This issue has not received the attention it deserves. There has been enormous scrutiny of fees, and the effect that they have on savings. Oddly, at the same time, there has been far too little scrutiny of rules that give rise to higher fees. Inconsistent rulemaking is certainly a huge creator of higher fees, as evidenced by the billions of dollars spent nationwide on the now-invalidated Department of Labor ("DOL") rule.

  Iowa's fiscal impact summary states that "the Division does not expect material implementation costs for broker-dealers." We disagree. Even if Iowa's best interest standard roughly mirrors the SEC's standard, any differences between the two rules will create new compliance costs. Further, any state rules will introduce another layer of interpretation and enforcement, which will differ from the SEC and create their own costs. Finally, even assuming for the sake of argument that Iowa's rule, by itself, will not create material costs, a patchwork regulation of broker-dealers by all 50 states will certainly create material costs and substantial compliance challenges for broker-dealers supporting clients in multiple states.

- **Cross border issues.** The proposal does not provide guidance on how to address cross border issues, such as the application of different state rules to broker-dealers providing assistance to investors in different states, leading to more confusion, uncertainty, and costs.

- **Great risk of errors and confusion.** We all know that our world is increasingly mobile. Broker-dealer agents move between states, as do their customers. With multiple different rules in different jurisdictions, inadvertent errors by broker-dealers will likely increase, causing confusion and possibly undermining investor confidence. And mobile investors receiving different types of advice in different jurisdictions cannot help but be confused.

- **Gaps in advice due to inconsistencies.** All firms are currently expending significant resources to develop systems to comply with the SEC's Regulation Best Interest. What happens when a state develops different rules that are inconsistent with the SEC rules, as is the case with the Iowa proposal? National firms will have no choice but to delay the provision of assistance in that state until systems are developed to deal with the differences, with the possibility that those differences cannot be dealt with and resolved easily, resulting in longer gaps in advice.

In short, it is very important for there to be as much uniformity as possible in the protection of investors. Accordingly, we support the national standard promulgated by the SEC and have great concerns about the application of any state-level broker-dealer standard, including the Iowa standard, to the extent that it adds to or differs from that national standard. For this reason, we support the creation of a safe harbor under which compliance with Regulation Best Interest constitutes compliance with the Iowa rule.

III. Treating non-fraudulent acts as fraud and private causes of action.

Non-fraudulent actions should not be treated as fraud. Iowa's proposal would treat violations of the proposed best interest standard as "an act, practice, or course of businesses which operates or would operate as a fraud or deceit under Iowa Code section 502.501(3) and a manipulative, deceptive or other fraudulent scheme, device, or contrivance under Iowa Code section 502.501A." We strongly disagree with this characterization.

Most fundamentally, this characterization has no basis, as it would, for no apparent reason, treat inadvertent failures as fraud. Why? And the consequences of this inappropriate treatment are severe. For example, because all failures are treated as fraud, a final order by the State finding a violation of the best interest rule would, even if inadvertent, subject a broker-dealer or agent to collateral consequences with other state and federal regulators, such as statutory disqualification under various provisions of the federal securities laws. We strongly urge the Insurance Division to reframe its best interest standard to avoid inappropriately characterizing non-fraudulent violations as fraud.

Expressly clarify no private causes of action. By treating violations of the proposed best interest standard as fraud, the proposal also appears to create a private cause of action to enforce violations of its best interest obligation. This is perhaps the most important difference between Iowa's proposed best interest rule for broker-dealers and the SEC's Regulation Best Interest. By comparison, the preamble to the SEC's Regulation Best Interest states: "we do not believe Regulation Best Interest creates any new private right of action or right of rescission, nor do we intend such a result."[1] And in a similar regard, Iowa's best interest proposal for annuity recommendations expressly states: "Nothing herein shall be construed to create or imply a private cause of action for a violation of these rules or to subject a producer to civil liability under the best interest standard of care outlined in rule 191—15.75(507B) or under standards governing the conduct of a fiduciary or a fiduciary relationship."

If the Insurance Division proceeds with its best interest obligation for broker-dealers, we strongly urge the Insurance Division to expressly state, using language similar to its proposed annuity standard, that the best interest obligation for broker-dealers shall not be construed to create or imply a private cause of action for any violation. If violations of the final rule can be enforced through private causes of action, this will significantly increase the costs for broker-dealers to service customers in Iowa. Those costs will inevitably be passed on to investors and could result in the elimination of various broker-dealer services to a large portion of Iowa investors. Furthermore, this regulatory action would be inconsistent with the SEC's efforts to avoid private causes of action to enforce its best interest standard and would likely be preempted.

The requested change is critical because we believe that it is very possible that violations of the proposed best interest obligation for broker-dealers could be enforced through a private cause of action. The Iowa Uniform Securities Act, like the securities statute in many states, includes a specific section describing the circumstances under which individual investors may pursue a private right of action against investment professionals to enforce securities-related misconduct. That section, as is the case in many states, says that "the rights and remedies provided by this chapter are in addition to any other rights or remedies that may exist, but this chapter does not create a cause of action not specified in this section [502.509] or [a subsection that requires broker-dealers to obtain insurance or post a bond in certain circumstances]."[2]

There is one private enforcement right under that civil liability section that would be particularly relevant to a violation of the proposed best interest obligation for broker-dealers. Specifically, Iowa Code Ann. § 502.509(2) states that "A person is liable to the purchaser if the person sells a security . . . by means of an untrue statement of a material fact or an omission to state a material fact necessary in order to make the statement made, in light of the circumstances under which it is made, not misleading, the purchaser not knowing the untruth or omission and the seller not sustaining the burden of proof that the seller did not know and, in the exercise of reasonable care, could not have known of the untruth or omission." The remedy for this type of violation is generally rescission.

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[1] 84 Fed. Reg. 33318, 33327 (July 12, 2019).

[2] Iowa Code Ann. § 502.509(13).

The proposed best interest obligation does not specifically say that a violation will treat a broker-dealer or agent as making an untrue statement or omitting a material fact. Nevertheless, because the proposal treats violations of the proposed standard as fraud or deceit, and fraud generally requires some kind of misrepresentation or omission, it seems very possible that violations of the proposed rule could be enforced through this statutory cause of action.

IV. Conforming the proposal to Regulation Best Interest.

Iowa's securities proposal differs from Regulation Best Interest in other material ways, primarily a disclosure and oversight obligation discussed below that does not appear in the SEC's Regulation Best Interest. If Iowa proceeds with its best interest obligation for broker-dealers and does not create the safe harbor described above, we urge the Insurance Division to conform the proposal so that it does not differ from Regulation Best Interest to avoid the adverse consequences described above.

As noted, Iowa's proposal contains a disclosure and oversight obligation that does not appear in the SEC's Regulation Best Interest. Specifically, Iowa's proposal would require a broker-dealer or agent, in making a recommendation, to exercise reasonable diligence, care, and skill to: Have a reasonable basis to believe that prior to or at the time of the recommendation the retail investor has been reasonably informed of the basis of the recommendation and the potential risks, rewards, and costs associated with the recommendation.

The preamble to the SEC's Regulation Best Interest expressly rejected a requirement for broker-dealers to disclose the basis and risks with respect to each recommendation, although it recognized that the general basis for a broker-dealer's recommendations must be disclosed (i.e., the firm's investment approach, philosophy, or strategy), in addition to a standardized discussion of risk.[3] Similarly, the SEC's Regulation Best Interest does not require broker-dealers to disclose, prior to or at the time of the recommendation, individualized cost disclosures for each recommendation. In fact, the preamble to the SEC's rule made clear that Regulation Best Interest "does not mandate individualized fee disclosure particular to each retail customer. Rather, the use of standardized numerical and other non-individualized disclosure (e.g., reasonable dollar or percentages ranges) is permissible."[4]

If Iowa proceeds with its best interest obligation for broker-dealers, and does not create a safe harbor for broker-dealers that comply with Regulation Best Interest, we urge the Insurance Division to conform the proposal to Regulation Best Interest, including removing this disclosure and oversight obligation. As discussed above, any inconsistencies between the state and federal standards will increase costs in a way that is harmful to investors. And as discussed below, to the extent that Iowa's proposal imposes disclosure rules that add to or differ from the SEC's Regulation Best Interest, those disclosure obligations will very likely be preempted by the federal securities laws, as discussed below.

[3] 84 Fed. Reg. at 33359.

[4] 84 Fed. Reg. at 33354.

V. **Preemption under NSMIA.**

Beyond the harms that will result if Iowa adopts a broker-dealer standard that adds to or differs from the SEC's Regulation Best Interest, any Iowa standards that add to or differ from the SEC's rule will likely be preempted and invalidated by federal securities law.

Express preemption through NSMIA. State laws and regulations can be preempted in different ways. One way is for Congress to expressly preempt the state regulation of certain conduct, as Congress has clearly done for broker-dealer conduct standards through the National Securities Markets Improvement Act of 1996 ("NSMIA"). As the congressional managers of the Conference Committee for that law explained, NSMIA's preemption provisions are intended to "eliminate duplicative and unnecessary regulatory burdens [imposed by the states] while preserving important investor protections by reallocating responsibility over the regulation of the nation's securities markets in a more logical fashion between the Federal government and the states."[5]

Through the addition of section 15(i) of the Securities Exchange Act of 1934, NSMIA prohibits states from subjecting broker-dealers to any requirement involving the "making and keeping [of] records," if such requirements "differ from, or are in addition to," the requirements already imposed by federal law.[6] This express congressional directive on broker-dealer recordkeeping was clearly intended to preempt any state regulation of broker-dealer standards that would, in effect, require broker-dealers to collect and keep records to document compliance with the law, which Iowa's best interest rule for broker-dealers will do, if it adds to or differs from the SEC's requirements. After all, any case brought by Iowa or individual plaintiffs to enforce Iowa's rules will be highly dependent on the broker's books and records regarding compliance steps, which have been declared "off limits" to the states by Congress.

Furthermore, as discussed above, Iowa's best interest obligation differs from the SEC's Regulation Best Interest by expressly adding a new disclosure prong regarding the basis for recommendations, potential risks, rewards, and costs. Since this disclosure requirement adds to the federal disclosure rules, it will be preempted by NSMIA because it will require records that add to or differ from the records required under federal law. This is the case for the specific disclosure requirement highlighted in this letter and any other additional disclosure obligation contemplated by the proposed rule.

Conflict preemption. In addition to express preemption, Congress can also impliedly preempt state laws and regulations through a constitutional principle known as "conflict preemption." Federal law can preempt a state law or regulation through "conflict preemption" in one of two ways. First, a state rule can be invalidated when it is impossible to comply with the federal and state rules at the same time.[7] ***Second, a state rule can be invalidated when it stands as an***

[5] H.R. REP. NO. 104-864, at 39-40 (Conf. Rep.).

[6] 15 U.S.C. § 78o.

[7] *English v. Gen. Elec. Co.*, 496 U.S. 72, 79 (1990).

obstacle to the accomplishment and execution of the full purposes and objectives of Congress.[8] This second type of conflict preemption, which is sometimes referred to as "obstacle preemption," provides a clear means for preempting Iowa's best interest obligation for broker-dealers to the extent that it adds to or differs from the federal standard.

In the context of broker-dealer regulation, there is a significant body of case law indicating that the imposition of state broker-dealer standards, especially as they relate to the forms of acceptable compensation and required disclosures, are preempted under the doctrine of implied conflict preemption when they exceed the federal standards. For example, in the mid-1990s, plaintiffs brought a series of common law fiduciary claims against broker-dealers alleging that the brokers breached their state fiduciary duties by failing to disclose to their customers the receipt of "order flow" payments. Essentially, the plaintiffs argued that state fiduciary standards required detailed disclosure of those payments, notwithstanding the fact that the SEC imposed less strenuous standards at the federal level.

In a string of opinions considering those claims, the highest courts of four states concluded that federal law preempted the detailed disclosure of order flow payments as an outgrowth of state fiduciary principles. According to the courts, those state-based obligations were more stringent than the federal rules crafted by the SEC and would create an obstacle to the accomplishment and execution of the full purpose and objectives of Congress, namely Congress' objective of entrusting the SEC to comprehensively and uniformly regulate broker-dealers under a national market system.[9] In many respects, that string of cases closely parallels current efforts by states to impose new broker-dealer standards that add to or differ from the SEC's Regulation Best Interest.

Accordingly, if Iowa finalizes a broker-dealer standard of conduct that adds to or differs from the SEC's Reg BI, which the Iowa proposal does, challengers seeking to invalidate the rule would prevail by applying similar logic – i.e., the Iowa rule would create an obstacle to Congress' objective of entrusting the SEC to comprehensively and uniformly regulate broker-dealers under a national market system. As explained above, the Iowa proposal appears to add to the federal regulation of broker-dealers by, at least: (1) creating new disclosure requirements, which the SEC expressly rejected; and (2) creating a new private enforcement right, which the SEC also expressly rejected when it recently promulgated its own standards of conduct for broker-dealers.

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[8] *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

[9] *See Guice v. Charles Schwab & Co., Inc.*, 674 N.E.2d 282 (N.Y. 1996) (concluding that federal law preempted state fiduciary standards requiring broker-dealers to disclose order flow payments because state-by-state fiduciary standards would defeat Congress's intent for the SEC to develop a national market system); *Orman v. Charles Schwab & Co., Inc.*, 688 N.E.2d 620 (Ill. 1997) (holding that federal disclosure rules for broker-dealers preempted state fiduciary standards that would obstruct the national market system Congress intended to foster); *Shulick v. PaineWebber, Inc.*, 722 A.2d 148 (Pa. 1998) (concurring) (concluding that the disclosure of order flow payments under a state fiduciary standard was preempted because allowing states to impose more stringent requirements on broker-dealers would render the federal scheme "largely nugatory" and would require brokers "to craft their disclosures to meet potentially dozens of different state standards"); *see also Dahl v. Charles Schwab & Co., Inc.,* 545 N.W.2d 918 (Minn. 1996) (concluding that federal law preempted state fiduciary standards for broker-dealers because Congress intended the SEC to regulate the securities markets and state law would effectively eliminate a form of compensation permitted by federal law).

We thank you for considering our views and for the opportunity to comment.

Sincerely,

Kent A. Mason